



UNIVERSITI PUTRA MALAYSIA

**Managing Financial Crisis
During Economic Downturn 1997 - 1999 :
Experience Of
Agenda Istimewa Sdn Bhd
A Developer of Kesuma Lakes Township**

Ooi Ling Hock

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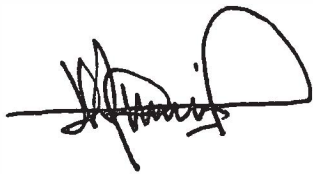
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PENGESAHAN KEASLIAN LAPORAN

Dengan ini saya Ooi Ling Hock, No, Matrik : GSO 1420, pelajar tahun akhir program Master of Business Administration, mengaku bahawa projek / kajian kes ini untuk kursus PSN 598 adalah hasil usaha asal saya sendiri.



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Abstracts

Agenda Istimewa Sdn Bhd, the developer of Kesuma Lakes Township, was doing reasonably well during 1996 and 1997. Everything look bright and good until the South East Asia Financial crisis hit Malaysia in the 4th quarter of 1997. Year 1998 was a chaotic year, the property prices drop by 20% ~ 40%, the sales not only drop but went into negative (withdrawal), sales forecast, cash flows projection and all other financial commitment could not be meet.

The consumer confident drop drastically.

The effective interest rate went up to as high as 16% per annum and the future of the company look bleak. Nevertheless Agenda Istimewa Sdn Bhd embark on a strategy to overcome the adversity. By adopting proactive measure to react to the market condition. The company adopt the defensive strategy by doing hard selling. They cut prices to generate turnover, they force the contractors and creditors to accept contra sales and try to conserve cash by managing the project and financial. With the support from the top management, the flexibility of product mix and quick charge in market towards better condition. They seems to turnaround but still more obstacles to cross. For the next 12 months they are short of 25 million for the next 12 months in cash flow and they need to plan and do something now

Universiti Putra Malaysia

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Downturn 1997 - 1999

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Being a case study submitted in Partial Fulfilment of

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By

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PART

1

PRELUDE

Zawani still thinking of how to reply to Mr. Lee, a bungalow lot purchaser writing to him for the 2nd time, demanding explanation on when he can start his bungalow house construction. Zawani wanted to tell Mr. Lee that he can start immediately to construct his dream 6 rooms double-storey colonial design bungalow. But from the information given by the project department, the contract on the sewerage plant is not finalised and the construction will take 12 months to complete. The main reason for the delay is that the company is tight in cash flows. The main sewerage plant and the pumping station is estimated to cost RM4 million to build. “ Six months to one year, depending on the size and design” was the answer given by May Loo, the lady project manager on how long a duration a double storey bungalow takes to be built? This means that even if the bungalow house is ready the company would not be able to obtain the certificate of fitness (CF) for it.

The bungalow lot Sales and Purchase Agreement does not promise a sewerage plant. Only a sewerage connection point was stated in the agreement. It does not promise the supply of water but only stated that the company must provide water piping.

Zawani started thinking of the story that his friend told him about the unscrupulous electrical trader selling refrigerator and TV to the rich Orang Asli in the Sarawak Jungle where there is no electricity supply. “Let the project department worry about this, I am only in charge of sales and marketing.” He wrote to inform him that he so he reply to Mr. Lee that he can start to construct his “dream bungalow house” immediately and cc a copy of the letter to project department.

PART 1

CONTENTS

	page
Prelude	
Table of Contents	
1. The Current Economic Situation And Its Effect On The Construction Industry	10
1.1 Reduction in salary and earning capacity	10
1.2 Increase in saving	11
1.3 Interest rate hike	11
1.4 The BNM loan classification	12
2 Company Background	13
2.1 Agenda Istimewa Sdn Bhd Background and Project Brief	13
2.2 Nam Fatt Corporation Berhad	14
3 Agenda Istimewa's Current Status	15
3.1 Agenda Istimewa current sales report as at 3 rd August 1999	15
3.2 The monthly accumulated sales figure from September 1996 to July 1999	16
3.3 AI projected sales	17
3.4 AI projected profit & loss account	18
3.5 AI projected cash flows	19
4 Strategy Planning	20
4.1 Direction, Mission Statement	20
4.2 Values	21
4.3 Current Product	22
4.3.1 Low Cost House	22
4.3.2 Medium Cost	22

4.3.3	Bungalow Land	23
4.3.4	Shop Offices	23
4.3.5	Industrial Land	24
5	AI Development Concept	24
5.1	Total Development Concept	24
5.1.1	Township Development	24
5.1.2	Low Density	25
5.1.3	Security	25
5.1.4	Resort Style Ambience	25
5.1.5	Club House Facility	25
5.1.6	Panoramic View	26
5.1.7	Lush Greenery	26
5.1.8	Reputable Developer	26
5.1.9	No Stay In Population	26
5.1.10	Distance from Kuala Lumpur	27
5.2	AI Financial And External Factors	27
5.2.1	Gearing	27
5.2.2	AI Cash Flow	28
5.2.3	Sales Withdrawals	28
5.2.4	Extra Loan	29
5.2.5	Agent Relationship	29
5.2.6	Public Relation	29
5.2.7	Support from Top Management	30
5.2.8	Within the Group Contractor and Suppliers	30
5.2.9	Good Construction Records by using IT	31
5.2.10	Experience Staffs	31
5.3	Current Issue In Development Sectors	32
5.3.1	Population Growth	32
5.3.2	The Speculators	32
5.3.3	Conventional Housing	32

	5.3.4	Foreign Purchase	33
	5.3.5	Loan Restriction To Foreigner	33
	5.3.6	Bank Negara Effort	33
	5.3.7	Interest Rate	34
	5.3.8	Government Effort	34
	5.3.9	General Economy Condition	35
	5.3.10	The Employment Condition	35
	5.3.11	Saving Pattern Of Malaysia Population	36
	5.3.12	Property as Investment	36
	5.3.13	Existing and Future Competitors	37
6		Agenda Istimewa Targeting	38
	6.1	Prospective Purchasers	
	6.2	Household Income Group, And Target Group Of Purchasers	
7		Conclusions	41
8		Tables	
	Table 1	AI current sales status	15
	Table 2	AI monthly accumulated sales in unit and value	16
	Table 3	AI projected sales for the next 12 months	17
	Table 4	AI monthly loan repayment for terrace house	39
	Table 5	Proposed household income group for terrace house purchasers	40
9		Figures	
	Figure 1	AI projected profit and loss account	18
	Figure 2	AI projected cash flow	19

Part 2

CONTENT

		page
1.0	SUMMARY OF THE CASE	43
2.0	THE COMPANY	44
2.01	The property market condition	44
2.02	Sales Market	45
3.0	PROBLEM STATEMENT	46
4.0	SCENARIO STRATEGY	47
4.01	Scenario Planning	47
4.02	Scenario Analysis	49
5.0	COMPANY STRATEGIC PLANNING	51
5.01	Mission Statement	51
5.02	Values	51
5.03	Object & Priorities	52
6.0	STRATEGIC PLANNING PROCESS	53
6.01	The factor affect the decision making	53
6.02	SWOT Analysis	53
6.03	Variables	54
6.04	Variable Analysis	54
7.0	SWOT ANALYSIS WORKING	55
7.01	External and Internal Variables Analysis	55
7.02	Internal Factors Evaluations	56

7.03	External Factors Evaluations	57
7.04	SEOT Matrix Construction	58
7.05	SWOT Analysis - Strategy & Action	60
7.06	Conclusion	61
8.0	SPACE ANALYSIS	62
8.01	Factors Evaluation	62
8.02	Space Analysis Chart	64
8.03	Conclusion	64
9.0	BCG MODEL & GEC MODEL	65
9.01	BCG Analysis On Product	66
9.02	GEC Analysis	67
9.03	Conclusion	68
10.0	AGENDA ISTIMEWA SDN BHD STRATEGY - ACTION CHART	69
10.01	Conclusion	70
11.0	CONCLUSION ON THE CASE	71
12.0	TABLES	
Table 6	External And Internal Variables Analysis	55
Table 7	Internal Factors Evaluations	56
Table 8	External Factors Evaluations	57
Table 9	Swot Matrix	58
13.0	FIGURES	
Figure 3	Space Analysis Chart	64
Figure 4	BCG Chart	66
Figure 5	GEC Chart	67
Figure 6	AI Strategy Action Chart	69

1.0 THE CURRENT ECONOMIC SITUATION AND ITS EFFECT ON THE CONSTRUCTION INDUSTRY

The South East Asia economic crisis started with the currency attack on Thai bhatt on 1-4-1997 and Malaysia suffered the same fate 7 months after the bhatt devaluation. Since November 1997, Malaysia reported negative Gross Domestic Product (GDP) of 6.7% for the year 1998 and negative 1.7% for the first quarter of 1999.

After going through 5 seasons of contraction consecutively, the 2nd quarter of 1999 is expected to register positive GDP growth. The GDP projected for 1999 is positive 1%. The economic contraction has greatly affected the construction sector mainly due to reasons discussed henceforth :

1.1 REDUCTION IN SALARY OR EARNING CAPACITY

During the year 1997 and 1998, the private sector has taken the opportunity to cut salary of the staff and reduce wages for labourers. As much as 30% reduction was reported especially in the construction sector and related industries, and generally 10% salary reduction in service and other industries. The reduction in salary has greatly affected the purchasing power of the general population especially for durable goods and capital consumption.

1.2 INCREASE IN SAVINGS

The economic downturn created a scenario of general increase in saving and reduction in consumption. The consumers consumption behaviour change towards “saving for the rainy days ahead.” Savings generally increase from 30% to 45% of earnings and the consumption of capital goods especially on car and residential units obviously decreased.

1.3 INTEREST RATE HIKE

The interest rate hiked from 9% in June 1997 to as high as 16% in the post crisis of August 1998. Bank Negara Malaysia (BNM) implemented the credit squeeze policy after November 1997. The Ringgit was devalued from 2.5 Ringgit to a US\$1, to as low as 4.8 Ringgit to one US\$. The interest hike from 9% to 16% per annum for housing loan has almost doubled the monthly repayment amount of a loan for 20 years tenure common in real estate end financing. The “non-affordability” occurred not only due to reduction in income, but also due to the increase in interest rate, making house purchase a difficult task.

The critical period or the turning point is when the Government, on September 1998, implemented the currency and capital control regulations. The Ringgit was pegged at RM3.8 to a US dollar, and interest rate was reduced to create more liquidity (in M1,

M2 & M3) to stimulate economy. Consequently, borrowing interest rate dropped from 16% to 5.55% for purchase of property and houses.

1.4 THE BNM LOAN CLASSIFICATION

The BNM started to classify property loans as “unproductive” in nature in June 1998. BNM also gave directive to all the banks to restrict the total loan percentage to the property sector. From June 1998 to as late as November 1998, practically no end financing was approved for property purchase except those from RM150,000 and below which was classified as “needed”, only for owner occupied and low and medium cost housing. All bridging loans to developers were suspended and even up to today (August 1999), no bridging is to be granted for new projects.

BNM ruling was greatly relaxed after 1st September 98, and from June 1999, the trend for end financing for home purchase is more favourable to the houses costing from RM150,000 to RM500,000, rather than those property RM150,000 and below. However, the strict guidelines are still applied to commercial lots, office space and industrial land purchases. Even bungalow land purchase is still discouraged by many banks.

In view of the improved market situation, AI as a developer in deep water, is trying hard to recover from the 1997 - 1999 financing crisis.

2. COMPANY BACKGROUND

- 2.1 Agenda Istimewa Sdn Bhd (AI) was incorporated on 16 November 1993 as private limited company under the Companies Act, 1965. AI presently has authorised share capital of RM65,000,000.00 ordinary shares of par value RM1.00 each, of which 62,965,280 have been issued and fully paid-up.

AI is developing a self-contained, integrated township in Semenyih which is estimated to cost more than RM1.4 billion. It is located just ten (10) minutes south of Kajang along the Kuala Lumpur - Seremban Highway. The 1,357 acre township will comprise the 900 acre Kesuma Lakes Residential development, the 457 acre Sciencity commercial and Industrial Park and will also house a private college, five (5) public schools, a medical centre, a police station and a fire station among others.

The township will take between eight (8) to ten (10) years to develop and will have an estimated population of 50,000.

With the development of numerous multi-million ringgit commercial and administration projects within its vicinity, Semenyih is strategically positioned as the growth centre in the southern corridor of the Klang Valley.

2.2 NAM FATT CORPORATION BERHAD

Nam Fatt Corporation Berhad, the parent company, was listed on the Kuala Lumpur Stock Exchange (KLSC) main board in 1992 and classified as an Engineering and Construction Company. Major operational activities included engineering, construction, property development, manufacturing and leisure. Group turnover for 1997 stood at RM887.6 million with a reported profit before tax of RM99.4 million.

Major contributor of the 1997 profit is Leisure Division in Hong Kong and China.

The group proposed to acquire the entire issued and paid-up share capital of AI for a total purchase consideration of RM190.5 million to be satisfied by issuance of new ordinary shares of Nam Fatt.

However, due to the currency crisis in South East Asia and subsequently the economic slow down, the securities commission, which approved the acquisition of AI to be satisfied by the issuance of new ordinary share of Nam Fatt revised the purchase consideration to RM144 million. However, the group took a bank loan of RM100 million to fulfil the obligation to pay for the consideration while the balance RM44 million was financed by group retained profit.

3. AGENDA ISTIMEWA'S CURRENT STATUS

3.1 As of 3rd August 1999, AI has managed to acquire sales value of RM365 million. The breakdown is as follows. The detail listing is in the appendix attached.

Table 1

AI current sales status

	Phase	Total Units	Sold Units	%	Sales Value (RM)
Bungalow Lots	1	710	579	82	101,695,396
Shop Offices	2	184	134	73	75,670,540
Industrial Lots	5	86	38	44	38,327,727
Double Storey Semi-D House (50 x 70)	3	136	79	58	21,010,469
Single Storey Semi-D House (50 x 70)	3	92	62	67	10,304,481
Double Storey Terrace House (22 x 70)	4	34	32	94	4,576,130
Double Storey Terrace House (18 x 70)	3	129	83	64	9,164,530
Single Storey Terrace House (22 x 70)	3	92	13	14	1,367,690
Single Storey Terrace House (22 x 70)	4	460	419	91	40,311,227
Single Storey Terrace House (18 x 60)	7	439	418	95	29,147,677
Low Cost Flat	6	2,000	856	43	33,394,600
Total		4,362	2,763	63	364,970,467

3.2 The monthly accumulated sales units and value is listed below

Table 2

AI monthly accumulated sales in units and value

Month	Year							
	1996		1997		1998		1999	
	Unit	Value	Unit	Value	Unit	Value	Unit	Value
January			632	172,033,200	773	227,832,409	1,556	261,057,769
February			688	187,560,800	763	222,641,140	1,575	262,918,709
March			749	217,211,439	750	210,432,641	1,608	268,916,680
April			755	221,287,818	742	203,652,494	2,113	294,037,344
May			763	222,613,633	732	199,211,710	2,383	314,003,567
June			762	222,552,033	725	192,903,320	2,475	321,861,347
July			760	221,910,833	722	192,043,430	2,763	364,970,467
August			768	224,004,733	705	183,958,070		
September	585	141,067,300	782	232,109,313	689	180,824,970		
October	596	144,228,400	784	232,876,319	831	191,946,868		
November	617	162,306,200	788	233,257,019	1,221	213,903,358		
December	621	163,513,900	784	232,152,019	1,437	249,617,397		

The sales which started in September 1996, increased consistently until September 1997, when the financial crisis hit Malaysia. The sales plateaued from September 1997 to November 1997, and started decreasing gradually from RM233 million in the latter month to RM180 million in September 1998. This was the time that AI went through the difficult time of negative sales growth. From October 1998 the sales picked up and accelerated from November to July of 1999. It is assumed that the sales will continue to do well in tandem with the economic recovery.

3.3 AI PROJECTED SALES

Following the current trend, monthly sales averaged about 100 units valued about RM9 million. Thus it is reasonable to project a sales volume of RM100 million or about 1,000 units of properties per year, if the situation improves. Based on the product available it is reasonable to project a sales of 200 million and if the property market turn bad, then a projection of 50 million sales can be achieved. Table below show the possible units and sales value projection.

Table 3

AI projected sales for the next 12 months

Product	Poor Sales		Fair Sales		Good Sales	
	Unit	Value (million)	Unit	Value (million)	Unit	Value (million)
1. Low Cost	1,000	40	1,000	40	1,000	40
2. Medium Cost	80	10	480	60	800	100
3. Bungalow Lot	-	-	-	-	100	20
4. Commercial Shop	-	-	-	-	50	20
5. Industrial Lot	-	-	-	-	20	20
Total	1,080	50	1,480	100	1,970	200

3.4 AI PROJECTED PROFIT AND LOSS ACCOUNT

The profit and loss projection was based on the fair sales projected in section 3.3. The projected profit of RM27 million was based on existing sales plus future sales, with the weightage of RM20 million profit for existing contract and another RM7 million profit from projected sales for the next 12 months. This indicated that the AI is doing reasonable well in business.

Figure 1

Projected profit and loss account for the year ended 30th September 2000

Turnover RM100,000,000

Profit before taxation RM 26,900,000

Projected Charges		
Directors remuneration	RM	100,000
Auditor's remuneration	RM	50,000
Provision for depreciation	RM	150,000
Hire purchase interest	RM	50,000
Lease Interest	RM	20,000
Management fees	RM	25,000
Rental of premises	RM	150,000

Provision for taxation RM 8,800,000

Projected profit after taxation RM 2,555,000

3.5 AI PROJECTED CASH FLOW

Figure 2

Projected cash flow statement for the next 12 months ended 30th September 2000

Cash flow from operating activities	
Profit before taxation	RM26,900,000
Adjustment for : -	
Provision for depreciation	150,000
	<hr/>
Operating profit before working	
Capital charges	RM11,750,000
Decrease in land held for future development	-
(Increase) in development work in-progress	(16,000,000)
(Increase) in trade debtors	(9,000,000)
Increase in trade creditors	8,000,000
Increase in advances from house buyer	4,000,000
Increase in amount owing to related companies	3,000,000
	<hr/>
Cash (used in) operating activities	16,750,000
Cash from financing activities	
Repayment of interest	(12,000,000)
Repayment of term loan	(30,000,000)
	<hr/>
Net cash generated used in financing activities	(42,000,000)
Net increase in cash and cash equivalents	(25,250,000)
Cash and cash equivalents at beginning of the year	250,000
Cash and cash equivalents projected by end of the projected period	(25,000,000)

AI projected cash flow shows as shown in Figure 2, indicated that the company is short of RM25 million for the next 12 months.

The cash needed are mainly used for repayment of interest and term loan which amounting to RM42 million (RM12 million and RM30 million respectively). Another main cash outflow is the increase in working capital. The two main contributing items are in increase in work in progress and increase in trade debtors which amounting to RM25 million (RM16 million and RM9 million respectively).

4.0 STRATEGY PLANNING

4.1 Direction, Mission Statement

“We will continue to build good quality homes, wherever it may be, and to seize every opportunities to gain an extra advantage. We believe in hardworking and will continue to motivate employee to achieve excellence in their field. We believe in nature and the best home is close to the nature and at the same time enjoy the modern facilities and amenities. We believe our business is in real estate.”

The mission statement reflects the view of the company is commitment and belief. From the operation side of it, it can be clearly demonstrated that the mission statement is helping the company to go through this period of difficult time. The company still continue to build good workmanship houses despite the economic

downturn and depress price. This created goodwill among the house buyers. AI still very much focus on the business it know best by continue to emphasis on the medium range housing.

4.2 Values

1. The management of AI believes in building quality affordable houses. At difficult time like this, the management still tries to provide value for money houses to their purchasers. Based on their past development experience in Kelab Golf Sultan Abdul Aziz Shah where they build about 700 houses, they have established their name as one of the best developers in Selangor and Klang Valley area.

The workmanship of the houses built by the company always live up to the standard and many purchasers has expressed their compliment and their preference of choice especially for the terrace houses.